

REPORT OF EXAMINATION  
OF THE  
CALIFORNIA LIFE AND HEALTH INSURANCE  
GUARANTEE ASSOCIATION

AS OF  
JUNE 30, 2010

Filed December 22, 2011

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Los Angeles, California  
December 13, 2011

Honorable Dave Jones  
Insurance Commissioner  
California Department of Insurance  
Sacramento, California

Dear Commissioner:

Pursuant to your instructions, an examination was made of the

**CALIFORNIA LIFE AND HEALTH INSURANCE GUARANTEE ASSOCIATION**

(hereinafter also referred to as the Association) at its home office located at 10780 Santa Monica Boulevard, Los Angeles, California 90025.

**SCOPE OF EXAMINATION**

The previous examination of the Association was made as of June 30, 2005. This examination covers the period from July 1, 2005 through June 30, 2010. The examination included a review of the Association's practices and procedures, an examination of management records, tests and analyses of detailed transactions within the examination period, and an evaluation of the assets and a determination of liabilities as of June 30, 2010, as deemed necessary under the circumstances.

In addition to those items specifically commented upon in this report, other phases of the Association's operations were reviewed including the following areas that require no further comment: organizational records.

## ASSOCIATION HISTORY

The Association was organized on February 10, 1994 by the California State Legislature by merging the Robbins-Seastrand Health Insurance Guaranty Association into the California Life Insurance Guaranty Association. The Association retains the rights, property and obligations of the predecessor associations.

The Association was organized pursuant to, and operates in accordance with, Division 1, Part 2, Article 14.7, Section 1067 of the California Insurance Code. In addition, the Association operates under a Plan of Operation approved by the California Department of Insurance. The purpose of the Association is to provide insolvency insurance for each member insurer and discharge its obligations under its insurance policies and to protect the policyholders against loss arising from the failure of an insolvent member insurer. All companies holding life, annuity, and health insurance certificates of authority in California are automatically members of the Association.

## MANAGEMENT AND CONTROL

The Board of Directors (Board), composed of representatives from eleven insurers, manages the Association. The directors are elected in three classes with staggered terms of three years for each class. Two of the classes have four directors and the third class has three directors. The Association notifies the Commissioner and requests written approval of the members of the Board as elected.

As of June 30, 2010, approximately 826 life and health insurance companies were subject to the California Life and Health Insurance Guarantee Association Act and were therefore Members of the Association.

The Plan of Operation, as amended on April 11, 2006, specifies that the number of the board of directors shall be eleven insurers. California Insurance Code Section 1067.06 states that the number of directors shall consist of not less than nine nor more than 13 member insurers. The following are members of the board and principal officers of the Association serving at June 30, 2010:

### Directors

<u>Name</u>	<u>Principal Business Affiliation</u>
Mark J. Backe	Northwestern Mutual Life Insurance Company
Eric C. DuPont	Metropolitan Life Insurance Company
William B. Fisher	Massachusetts Mutual Life Insurance Company
Kris Frank	Aetna Life Insurance Company
Gary K. Hoffman	Kansas City Life Insurance Company
Diana M. Marchesi	Transamerica Life Insurance Company
John R. Mathews	Allstate Life Insurance Company
Charleen M. Milburn	United Healthcare Insurance Company
Stephen E. Rahn	Lincoln National Life Insurance Company
Barrie Stokes	West Coast Life Insurance Company
Todd R. Thakar	Prudential Insurance Company of America

### Principal Officers

<u>Name</u>	<u>Title</u>
Todd R. Thakar	Chairman of the Board
Mark J. Backe	Vice-Chairman of the Board
Eric C. DuPont	Secretary and Treasurer

### Conflict of Interest

As the result of the review of the Association's conflict of interest policy, it was determined that a representative of one of the directors did not timely sign the conflicts of interest statement. The Association requests that all officers and directors sign and return the conflicts of interest statement in a timely manner. The Association's Chairman of the Board obtained the conflicts of interest statement from this individual on December 13, 2011.

## Management Agreements

Professional Service Agreement: On August 1, 1998, the Association entered into a Professional Service Agreement with Guarantee Association Administration, LLC (the Administrator), a Delaware Limited Liability Company, to manage the affairs of the Association.

The Administrator performs all services as delegated by the Association's Board of Directors (the Board). Services that are performed include: maintain office, handle communications, record keeping, filing, storage, assessments, administration of claims, communication with National Organization of Life and Health Insurance Guaranty Associations (NOLHGA), attend NOLHGA task force meetings, monitor insolvencies, communicate with the Board, and maintain the needed systems and employees to handle all affairs of the Association as an independent contractor. The Association pays monthly fees of \$26,950 for services rendered by the Administrator. The Association itself has no employees. Personnel servicing the Association are provided by the Administrator.

Legal Retainer Agreement: On March 1, 2010, the Association entered into a Legal Retainer Agreement with Norwood & Associates (Firm) for consulting services regarding representation of its interests before the California State Legislature, Executive branch, and administrative agencies. The Firm provides consulting, government relations, and lobbying services. The Association compensates the Firm for consulting and lobbying services in the amount of \$40,000 for the legislative session and calendar year. The retainer was paid with an initial sum of \$4,000 upon execution of agreement followed by nine equal payments of \$4,000 upon receipt of invoice from the Firm. The Association reimburses the Firm for all reasonable out of pocket costs, including lobbying expenses, requested travel and entertainment, and for the preparation and filing of all applicable registration, lobby and contribution reports.

Lease Agreement: A new standard office lease was entered effective July 1, 2009 between AG/Cambra, a Delaware limited liability company and Peter Leonard, Executive Director of California Life and Health Insurance Guarantee Association. The basic lease term is five years and four months, commencing on July 1, 2009. The monthly basic rental fee is \$7,629 for the first year

and rent will incrementally increase by \$0.09 per square foot each year for the next four years. The rental fee is included as part of the monthly fee in the professional service agreement noted above.

Third Party Administrator: The Association is party to agreements signed by NOLHGA with various administrators to administer claims and collect premiums of life health and annuity contracts for liquidations assigned to the Association. The third party administrators used by the Association as of June 30, 2010, follows:

Third Party Administrator	Line of Business	Insurance Company
Pennsylvania Department of Insurance	Health	Reliance Insurance Company
R. N. Swanson	Life	Supreme Life Insurance Company of America
Special Deputy Receiver of Lincoln Memorial Life Insurance Company	Life	Lincoln Memorial Life Insurance Company
Special Deputy Liquidator of Medical Savings Insurance Company	Health	Medical Savings Insurance Company
The Receiver of Universal Life Insurance Company	Life	Universal Life Insurance Company

Other than an early termination for a material breach, the above agreements are effective until final disposition of all covered claims or it may be terminated by request of a participating guaranty association through NOLHGA.

#### FIDELITY BONDS AND OTHER INSURANCE

The Association carries business insurance including coverage for commercial excess and umbrella, commercial automobile liability and property. However, the Association currently does not carry fidelity insurance coverage. The Association reviewed available fidelity coverage and, after due consideration by the board, determined that such fidelity coverage would not be acquired due to the cost and coverage limit considerations.

## TERRITORY AND PLAN OF OPERATION

Insurance companies writing life and health insurance business in California (with the exception of companies specifically exempted pursuant to California Insurance Code (CIC) Section 1067.04(i)(1 through 8) are required to participate in the California Life and Health Insurance Guarantee Association. If an admitted life and health insurance company becomes insolvent, the Association administers covered policyholder claims and assesses each life and health insurance company up to 1% of written premium in the appropriate line of business. CIC Section 1067.08 requires member insurers to surcharge policies to recover health insurance account assessments.

The Association has the responsibility to pay and discharge covered claims of member insurers as of the date a court of competent jurisdiction declares such member insurer insolvent and a liquidator is appointed. Covered claims primarily include the policy obligations of insolvent insurers arising from life, health, annuity, and supplemental policies and contracts coverage (exclusive of those lines not included per CIC Section 1067.02).

The Association allocates its claim payments and costs, incurred or estimated to be incurred, to one or more of the following categories: (a) life claims; (b) annuity contracts, and (c) health claims. Separate premium charges (assessments) are required for each category. The assessments for each category are used to pay the claims and costs allocated to that category.

CIC Section 1067.02 establishes that the benefits for covered life and annuity claims are limited to the lesser of: (1) eighty percent of the contractual obligations for each policy or contract; or (2) \$100,000 of the present value of an annuity contract, \$100,000 of cash surrender value of a life insurance policy, or \$250,000 in life insurance death benefits. Coverage is determined after adjusting the covered policy or contracts interest crediting rates so that the rate credited by the insolvent insurer does not exceed a rate of interest determined by subtracting six percentage points from Moody's Corporate Bond Yield, but not below a minimum of three percent. Maximum health insurance coverage is limited to \$200,000, subject to an adjustment based upon changes in the health care cost component of the Consumer Price Index.



When a life and health insurance company becomes insolvent, the control of its assets transfers to the state insurance liquidator in its domiciliary state. The liquidator uses the assets of the insolvent insurance company to settle the outstanding liabilities of the company. Liquidators may advance estate distributions to the Association prior to settlement of the insolvent insurance company outstanding debts. The Association recognizes these advances as revenue when received. The advances are utilized to discharge claims against the insolvent insurance companies. The respective liquidator can recall these advances, in whole or in part. The Association recognizes any recall of advances when notified by the liquidator or receiver.

To the extent that assets, including advances from liquidators, are insufficient to discharge the Association's obligations, the Association assesses member insurers when determined necessary by the Board. Conversely, to the extent that the assets exceed the ultimate cost of claim obligations for insolvent insurers, the excess fund balance, if any, will be refunded or applied to reduce future assessments by the Association in the appropriate category.

Assessments are accrued as of the date declared by the Board and become due from the member insurers no less than thirty days after assessed. The rate of assessment to each member insurer is initially based on the average written premium for the three years preceding the insolvency, as shown on the annual financial statements filed with the California Insurance Commissioner.

As of June 30, 2010, the Association continues to satisfy its statutory obligations to contract-holders for 23 insolvencies both active and inactive. For the year ended June 30, 2010, the Association paid out approximately \$2.1 million in direct benefits, primarily for life insurance death benefits related to Lincoln Memorial Life Insurance Company and medical insurance claims related to Medical Savings Insurance Company. During the same annual period, the Association paid approximately \$12.2 million for benefits through an enhancement agreement that related to the Executive Life Insurance Company insolvency.

## REINSURANCE

Traditional reinsurance, entered into by member insurers prior to their insolvencies, is administered by the liquidator of the insolvent member insurer and is therefore excluded from the Association's financial statements. Reinsurance recoveries made by the liquidator may be advanced to the Association subject to the priority needs of the estate in liquidation. Ancillary liquidations may also have a demand on assets recoverable, including reinsurance recoverables and special and statutory deposits.

## INVOLVEMENT WITH INSOLVENT INSURERS

From its inception, the Association has become responsible for the payment of benefits to California resident policyholders and contract holders of the following insolvent member insurance companies:

<u>Insolvency</u>	<u>Year Activated</u>
Executive Life Insurance Company	1991
Great Republic Insurance Company	1991
Inter-American Insurance Company of Illinois	1991
Legacy Life Insurance Company	1991
Midwest Life Insurance Company	1991
Mutual Security Life Insurance Company	1991
Fidelity Bankers Life Insurance Company	1992
American Integrity Insurance Company	1993
Investment Life Insurance Company of America	1993
New Jersey Life Insurance Company	1993
Confederation Life Insurance Company (U.S.)	1994
Consumers United Insurance Company	1994
Kentucky Central Life Insurance Company	1994
Mutual Benefit Life Insurance Company	1994
Old Colony Life Insurance Company	1994

Summit National Life Insurance Company of America	1994
National American Life Insurance Company of PA	1995
Supreme Life Insurance Company of America	1995
American Western Life Insurance Company	1997
Centennial Life Insurance Company	1998
Universe Life Insurance Company	1998
First National Life Insurance Company of America	1999
International Financial Services Life Insurance Company	1999
Statesman National Life Insurance Company	1999
American Chambers Life Insurance Company	2000
Combined Benefits Insurance Company	2000
Reliance Insurance Company	2001
Legion Insurance Company	2003
Villanova Insurance Company	2003
London Pacific Life & Annuity Company	2004
Lincoln Memorial Life Insurance Company	2008
Medical Savings Insurance Company	2009
Imerica Life and Health Insurance Company	2010
Universal Life Insurance Company	2010

The Association has monitored the progress of other member insurance companies presently in conservation and rehabilitation where the Association may, at some time in the future, incur liability for benefit payments to California resident policyholders and contract holders. Companies in this category include:

American Network Insurance Company  
Executive Life Insurance Company of New York  
Fremont Life Insurance Company  
Golden State Mutual Life Insurance Company  
Monarch Life Insurance Company

Penn Treaty Network America Insurance Company  
Standard Life Insurance Company of Indiana

FINANCIAL STATEMENTS

The financial statements prepared for this examination report include:

Balance Sheet as of June 30, 2010

Statement of Activities for the Year Ended June 30, 2010

Statement of Changes in Members Net Asset (Deficit) for the Years ended June 30, 2009  
and June 30, 2010

Statement of Cash Flows for the Year Ended June 30, 2010

Balance Sheet  
as of June 30, 2010

<u>Assets</u>	<u>Ledger and Nonledger Assets</u>	<u>Net Admitted Assets</u>	<u>Notes</u>
Cash and short-term investments	\$ 35,372,668	\$ 35,372,668	(1)
Assessments receivable:			
Called, net of allowance for uncollectible balances of \$7,657,190	421,443	421,443	(2)
Declared but not yet called	117,765,329	117,765,329	(2)
Accrued interest income	757	757	
Other assets	<u>240,174</u>	<u>240,174</u>	
Total assets	<u>\$ 153,800,371</u>	<u>\$ 153,800,371</u>	
<u>Liabilities and Members' Net Assets</u>			
Reserves for obligations to policyholders of impaired and/or insolvent insurers and administrative expenses		\$ 146,280,000	(3)
Assessment refunds due to members		238,004	
Other liabilities		<u>592,898</u>	
Total liabilities		147,110,902	
Members' net assets		<u>6,689,469</u>	
Total liabilities and members' net assets		<u>\$ 153,800,371</u>	

Statement of Activities  
for the Year Ended June 30, 2010

Revenue

Assessments declared	\$ 206,500
Premiums	590,457
Early access distributions from liquidators	783,250
Early access distributions repaid to liquidators	(807,371)
Interest income, less expense of \$66,650	<u>(33,533)</u>
Total revenue	<u>739,303</u>

Expenses

Claims and claims handling:	
Benefits paid	\$ 2,127,129
Assumptions reinsurance payments, net	12,150,895
Change in reserves for obligations to policyholders of impaired and/or insolvent insurers	<u>(17,602,000)</u>
Total claims and claims handling	<u>\$ (3,323,976)</u>
Legal and professional	199,366
Accounting and auditing	39,900
NOLHGA dues and auditing	1,694,066
Travel	21,368
Uncollectible member assessments	12,503
General and administrative	24,869
Professional services contract	<u>323,400</u>
Total expenses including claims and claims handling	<u>\$ (1,008,504)</u>
Change in members' net assets	<u>\$ 1,747,807</u>

Statement of Changes in Members' Net Asset for  
the Years Ended June 30, 2009 and June 30, 2010

	<u>Total Members' Net Assets (Deficit)</u>
Members' Net Deficit, July 1, 2008	(\$64,582,958)
Changes in members' net assets	<u>69,524,620</u>
Balance, June 30, 2009	4,941,622
Change in Members' net assets	<u>1,747,807</u>
Members' Net Asset, June 30, 2010	<u>\$ 6,689,469</u>

Statement of Cash Flows  
for the Year Ended June 30, 2010

For the Year Ended  
June 30, 2010

Assets

Cash flows from operating activities:	
Cash received from member company assessments	\$ 199,209
Cash received from policy premiums	590,457
Cash received for early access distributions	783,250
Cash paid for early access distributions	(807,371)
Interest received, net of investment expenses	(33,141)
Cash paid for policyholder obligations	(14,441,161)
Cash paid for consultants and suppliers	(2,568,976)
Net Cash provided by operating activities	(16,277,733)
Net decrease in cash and cash equivalents	(16,277,733)
Cash and cash equivalents at beginning of year	51,650,401
Cash and cash equivalents at end of year	\$ 35,372,668
Reconciliation of members' net assets to net cash used	
In operating activities:	
Change in members' net assets	\$ 1,747,807
Adjustments to reconcile change in members' net assets to net cash from operating activities:	
Reserves for obligations to policyholders of impaired and/or insolvent insurers administrative expenses	(17,602,000)
Decrease (increase) in:	
Assessments receivable	(1,628)
Accrued interest income	392
Other assets	(194,176)
Increase (decrease) in:	
Assessment refunds due to members	6,839
Other liabilities	(234,967)
Net cash provided by (used in) operating activities	(\$16,277,733)



## COMMENTS ON FINANCIAL STATEMENT ITEMS

### (1) Cash and Short-Term Investments

The Association's investment policy is to limit its portfolio to investment in United States (U.S.) Government, and U.S. government agencies instruments with maturities not to exceed 90 days. The Association maintains its cash in a federally insured banking institution and the account balances at June 30, 2010 was \$6,123,994.

### (2) Assessments Receivable

There are two classes of assessments to member companies. Class A assessments are made for the purpose of meeting general and administrative expenses of the Association. Class B assessments are necessary to discharge the duties of the Association to California resident policyholders due to a particular insolvency. Class B assessments are shared by member companies in the proportion to average premiums written in California for each line of business (life, annuity, and health) for the past three years prior to the year of liquidation. The assessment to each member may not exceed 1% of the members' three-year average premiums. To the extent the assessment exceeds the cost of an insolvency the assessment is refunded to the members.

Assessments receivable: Called, net of allowance for uncollectable balances, was \$421,443 which was comprised primarily of balances for Class A Assessments approved at the May 18, 2010 Annual Meeting of the Board of Directors.

Assessments receivable: Declared but not yet called, of \$117,765,329, was comprised primarily of \$94,821,529 for Executive Life Insurance Company, \$19,000,000 for Lincoln Memorial Life Insurance Company and \$3,000,000 of Medical Savings Insurance Company

During the year ending June 30, 2010, the Association declared \$206,500 of Class A (administrative) assessments. The Association did not declare Class B assessments in 2010.

Assessments are recorded when declared by the Association. The Association will call the declared assessment, as needed, at which time it is payable by member companies. The assessments called and not collected by the Association are booked net of an allowance for uncollectable assessments from insolvent companies.

(3) Reserves for Obligations to Policyholders of Impaired and or Insolvent Insurers and Administrative Expenses

The carried reserves are based on estimates provided by the state insurance liquidators and verified by the National Organization of Life and Health Insurance Guaranty Associations (NOLHGA) task forces (who rely on the work of retained actuaries and consultants) on behalf of various state guaranty associations. The reserves are based on actuarial estimates based on underlying data maintained by various state insurance liquidators, reinsurers, or third parties. This information is not always available or reliable for an accurate estimate for future obligations. For these reasons it is not practical for the examiner to extend procedures sufficiently to validate the data (nor is it cost effective to have additional actuarial studies performed pursuant to the examination to determine reserve accuracy). Therefore, the examination was limited-in-scope as regards to the procedures used to verify the Association's reserves for obligations to policyholders of impaired and or insolvent insurers and administrative expenses, estimated at \$146 million. The examiner relied on estimates, without testing, as provided by the state insurance liquidators and as verified by NOLGHA's task forces.

The Executive Life reserve of \$135 million or approximately 92% of the total reserves for policyholder obligations recognized by the Association is based on an enhancement agreement with Aurora National Life Assurance Company (Aurora). Pursuant to the enhancement agreement, Aurora acquired certain contracts from Executive Life Insurance Company (Executive Life) and, in return, most state guaranty associations, including the Association, make contributions to fund their obligations under the enhancement agreement. The enhancement agreement's contractual terms and the Association's other obligations related to the Executive Life insolvency require estimated payments over the remaining terms of the underlying contracts of approximately \$12 million per year.

The Lincoln Memorial Life Insurance Company (Lincoln Memorial) reserve at \$10 million, or approximately 7% of the total Association reserves for policyholder obligations, is approximately equal to the Association's remaining obligation in relation to the face value of life insurance policies owned by California residents.

## SUMMARY OF COMMENTS AND RECOMMENDATIONS

### Current Report of Examination

Management and Control - Conflict of Interest (Page 4): As the result of the review of the Association's conflict of interest policy, it was determined that a representative of one of the directors did not timely sign the conflicts of interest statement. The Association requests that all officers and directors sign and return the conflicts of interest statement in a timely manner. The Association's Chairman of the Board obtained the conflicts of interest statement from this individual on December 13, 2011.

### Previous Report of Examination

Management and Control - Business Insurance Coverage: With concurrence of the Board, the Association does not currently carry fidelity insurance coverage due to cost and coverage limit considerations. As of the date of the examination, the Association with concurrence of the Board, does not currently carry fidelity insurance coverage.

### ACKNOWLEDGMENT

Acknowledgment is made of the cooperation and assistance extended by the Association's officers and employees during the course of this examination.

Respectfully submitted,

\_\_\_\_\_/S/\_\_\_\_\_  
Ralph Oseguera  
Examiner-In-Charge  
Department of Insurance  
State of California